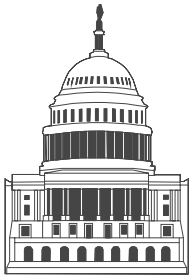
SENATE REPUBLICAN CAUCUS CHAIRMAN



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2003-04 BUDGET ANALYSIS

"The Legislative Analyst's report concludes that the $8 billion realignment program could place local governments at great financial risk with the proposal to utilize new, potentially highly volatile tax increases. We must be prudent in our deliberations of this precarious proposal, both in terms of the harmful tax burden and negative impact on local government."

-Chuck Poochigian

FEBRUARY 24, 2003

Senator Charles S. Poochigian

Capitol Update

Analysis of 2003 Budget Released

Last week, the non-partisan Legislative Analyst's Office (LAO) released its annual review of the Governor's budget. The analyst concluded that the Governor's projected budget deficit of $34.6 billion is overstated to accommodate his desire to increase spending. However, the LAO cites the actual structural deficit would be roughly $18 billion annually. "Structural deficit" refers to a chronic imbalance between state revenues and expenditures. State funding from all sources - General Fund, special funds, federal funds and bond funds would bring the ***total spending by state government in excess of $147 billion this coming year.***

ATTEMPTING TO BRIDGE THE GAP
Following an explosion of state spending of 33 percent between 1998-99 and 2001-02, the Governor's budget solution is based more on adjustments and tax increases than on budget cuts. Forty percent of the Governor's proposal relates to program cuts or savings. Tax increases, realignment, shifting local government resources to the state, fund shifts, transfers, and loans/borrowing account for 60 percent of the Governor's proposed solution.

Governor's Proposal (millions)	2002-2003	2003-2004	Percentage of the Solution
Program Savings/Cuts	$2,700	$11,000	40%
Tax Increases, Realignment, Loans, etc.	$2,800	$18,100	60%

REALIGNMENT
The Governor's budget proposes three major tax increases totaling $8.3 billion (see below), which would support the realignment of programs from the state to local governments. The programs that would be realigned include portions of Medi-Cal, substance abuse programs, welfare administration, and trial court security. The LAO notes that the proposed taxes are quite volatile, especially the Personal Income Tax (PIT) increase, and may not provide local governments with the promised revenues. According to the Legislative Analyst, the Governor's realignment program could shift the fiscal crisis to local governments due to the projected growth in realignment revenue being lower than overall projected growth in the programs being shifted to local governments.

TAX INCREASE PROPOSAL: $8.3 Billion

1) **Increase the Personal Income Tax (PIT) to 10 and 11 percent: $2.6 Billion**
The analysis states that income for the targeted bracket increased by 28 percent and fell by over 22 percent within a 2-year period, and it is anticipated that this volatility will continue. Moreover, 80 percent of California business taxpayers pay income under the personal income tax law and 50 percent of business income is paid through the PIT. In 1991, the last time the 10 and 11 percent brackets were enacted on a temporary basis, actual collections were almost 50 percent less than over the following several years.

2) **1 percent increase in Sales and Use Tax: $4.6 Billion**
The LAO cites concern about the fact that sales tax collections have been declining.

3) **$1.10 per-pack increase on the cigarette tax: $1.2 Billion**
The Legislative Analyst notes that there is a downward trend in cigarette smoking and that per capita smoking has fallen. Additionally, the LAO cites the vulnerability to evasion and more decline due to potential price increases.

EDUCATION - THE PROP 98 FORMULA
The California Constitution requires a minimum funding level for schools. The level is based on a formula that includes an index of personal income and the level of property tax revenues. The Governor's proposal of $6,723 per-pupil represents an increase of .6 percent relative to the revised current-year estimate, but this represents a 5.1 percent decrease from what the Legislature passed in the *2002 Budget Act*. Additionally, the Governor is proposing a $2.6 billion across-the-board cut to education. While the General Fund support of Proposition 98 decreases slightly, the LAO has estimated a $677 million increase in local property taxes to support Proposition 98.

TRANSPORTATION
The Governor's budget proposes a $1.7 billion shift from the Transportation Congestion Relief Fund (TCRP) and Transportation Investment Fund (TIF)- that had been touted by the Governor in the last three years as major boosts to regional transportation infrastructure – to the General Fund. The TCRP was first proposed by Governor Davis in 2000 with new money for transportation projects circumventing the California Transportation Commission system by substituting the Governor's priorities for more deliberative decision-making under the State Transportation Improvement Program (STIP). The LAO's analysis finds that this shift would leave no funding for TCRP projects in 2003-2004, and leave merely $300 million in TCRP for current year expenditures that have already occurred. Furthermore, the LAO suggests that this will contribute to the deficit because TCRP projects will continue to incur expenditures in the budget year unless outstanding contracts are terminated. The analysis indicates that the shift in these funds will ultimately create uncertainty about the eventual fate of badly needed traffic relief projects.

WILLIAMSON ACT
The Governor proposes to permanently eliminate Williamson Act subvention funds to local governments, effectively eliminating a valuable tool that assists rural communities. According to the Legislative Analyst, the elimination of this subvention would result in immediate uncompensated tax losses. This reduction will result in pressure on counties to eliminate support for this program that aids family farms and reduces the conversion of prime agricultural land to commercial development.